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UNCLAS SECTION 01 OF 02 CHENGDU 001250

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STATE PLEASE PASS FEDERAL RESERVE SYSTEM FOR WARSH AND FRB SAN FRANCISCO FOR CURRAN

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SUBJECT: FEDERAL RESERVE LOOKS AT SOUTHWEST CHINA DEVELOPMENT PROSPECTS

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**¶1.** (SBU) Summary. A Federal Reserve delegation visited Chengdu from November 28-30. According to local government leaders, the economies of Sichuan and Chengdu will continue to grow rapidly, although environmental protection is a concern. Representatives of smaller U.S. businesses operating in Chengdu complained of lack of government transparency and human resource problems.  
End summary.

**¶2.** (U) Federal Reserve System Governor Kevin Warsh, San Francisco Federal Reserve Bank (SFFRB) President Janet Yellen, SFFRB International Research Group Vice President Reuven Glick, and SFFRB Group Vice President and Deputy for Banking Supervision and Regulation Teresa Curran visited Chengdu November 28-30 to meet with local officials and to discuss economic prospects for China's southwest with representatives of U.S. businesses.

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HARMONY, HARMONY, HARMONY  
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**¶3.** (SBU) Sichuan Development and Reform Commission (SDRC) Director Xie Hong used the term "harmonious" at least three times during his description of the provincial and central government's plans for the area's economic development. He said that Chengdu was not "representative" of the province generally, noting that Sichuan's population was heavily rural. Therefore, authorities needed to ensure that the benefits of economic development were spread fairly throughout society, so development could be both "sustainable" and "harmonious," said Xie. Strict environmental protection was also necessary to ensure "harmony between man and nature." Asked about the province's efforts to attract FDI, Xie acknowledged that to succeed the province must "do better than Shanghai or Beijing."

**¶4.** (SBU) On the question of province's revenues, SDRC Finance Director Guo said that local taxes and fees were sufficient to cover approximately one-half of the province's expenditures, with the rest coming from the central government. She explained that the province received revenues from the central government both in the form of refunds of taxes paid by local and provincial authorities, and in the form of direct payments.

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BUT NOT JUST HARMONY, ALSO CONTENTMENT  
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**¶5.** (SBU) Chengdu Executive Vice Mayor Liu Peizhi outlined the

factors driving the city's recent growth, which he stated had averaged 13 percent per year over the previous five years. He seemed particularly proud of one result, which was an increase in the city's fiscal revenues from 36 billion RMB (approx. USD 4.5 billion) in 2005 to a projected figure of 43 billion RMB (approx. USD 5.4 billion) in 2006. He claimed that only seven percent of the city's economy was based on agriculture, while heavy industry accounted for over 41 percent, the remainder coming from "tertiary" industries, including the service sector.

However, he admitted that the city's logistics sector was "lagging." Summing up Chengdu's advantages, he said that it was a "happy place to be," due to its "harmonious society" and the ability of its residents to "live and work in peace and contentment."

¶ 16. (SBU) Asked about environmental concerns, Liu pointed to water pollution on the upper Yangtze as one of his primary worries. With heavy population pressure along the river's upper stretches and tributaries, Liu said that it was almost impossible to stop the discharge of untreated wastewater, even though modern treatment plants have been built. Following the meeting, a Foreign Affairs Office (FAO) representative tried to downplay Liu's comments about Chengdu's environmental problems.

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THE U.S. BUSINESS COMMUNITY SOUNDS OFF  
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¶ 17. (SBU) At a luncheon event organized by AmCham Sichuan, local representatives of U.S. businesses aired their concerns over the province's business environment. With heavy representation from U.S. SMEs, attendees complained of difficulty getting commercial credit from local banks, and problems in dealing with China Customs and agricultural inspection services. The transparency of government decision-making was a common grievance, along with human resource problems. One representative of a firm manufacturing precision instruments said that he had to spend up to 50 percent of his time on personnel issues, while in the

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United States he would expect to spend less than ten percent of his time on such matters.

¶ 18. (SBU) The delegation visited Intel's assembly and packaging facility in Chengdu to meet with managers. Intel Chengdu's Chief Financial Officer David Schmid told the delegation that the main reason for locating the plant there was to take advantage of low labor costs (which he said were one half to two thirds those of Shanghai) and to be closer to the firm's markets in southeast Asia. He added that the plant had experienced a very low rate of confidentiality or trade secret violations, which he attributed to a low turnover rate and to good business practices. Unlike the SME attendees at the lunch event, Schmid had few complaints about government transparency, China Customs, or the availability of credit.

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FRANK TALK FROM THE NEW HOPE GROUP  
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¶ 19. (SBU) New Hope Group Chairman Liu Yonghao gave the delegation a brief history of his firm's rise from selling bicycles and watches in 1982 to its present status as one of China's leading agribusiness concerns (it also has finance, chemical, and construction divisions). His major concerns for the continued development of southwest China's economy included the quality of its workforce, along with the need to improve the transportation, energy, and logistics sectors. He called U.S. investment in China's banks "very positive." Asked about his worries for China's overall political and economic future, Liu said that stability was the most important thing, but that continued market opening and political reform were necessary to maintain that stability. He added his view that the economy (and especially the agricultural sector) remained vulnerable to "external shocks" such as SARS and avian influenza.

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COMMENT  
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¶110. (SBU) Concerns over workforce quality, the environment, the banking system, and social stability are hardly unique to southwest China. However, transportation and logistics problems as well as local government attitudes seem to remain significant obstacles to the area's development. In the short term at least, large investors here will likely continue to enjoy significant advantages over SMEs in their dealings with local officials.

BOUGHNER